

COVID-19

# HIGH TIME FOR ISLAMIC BANKS

*To Show They Are Indeed Value-Based Intermediaries*



By Research Management Center,  
INCEIF

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The novel COVID-19 pandemic has caused an unprecedented human crisis around the globe. The necessary actions implemented to contain the virus have sparked both economic and social downturn. It shows the fragility and unpreparedness of the economy to face such a pandemic. Significant weakening of economic conditions has escalated the pressure on households, businesses and financial markets. Governments all over the globe are in the process of formulating and implementing appropriate policies to continue economic activities amidst this turmoil. Financial institutions are obligated to respond towards the policies adopted by respective governments.

Besides the Government (policy makers and regulators), financial institutions, sitting at the heart of the economy, have a crucial responsibility in dealing with the adverse effects of COVID-19. Conventional and Islamic banks, takaful and insurance operators in Malaysia have already embarked on many important measures to mitigate the financial difficulties of individuals and businesses. Financial incentives or relief provided by these institutions covers specific needs of individuals, SMEs and other relevant sectors of the economy.

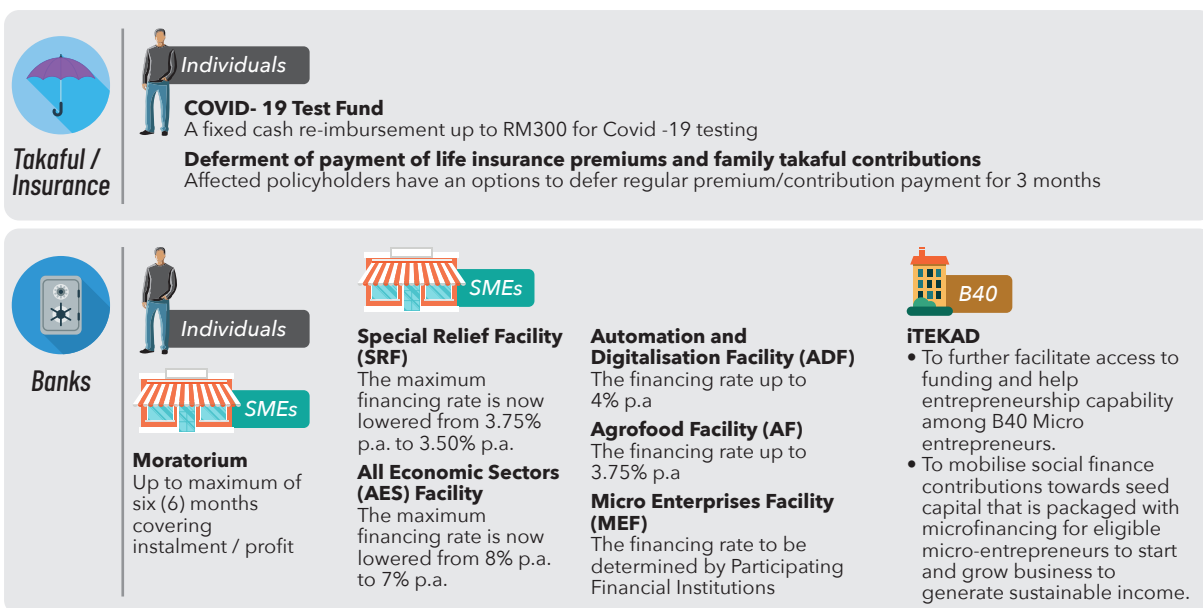


Figure 1: Financial incentives and Relief provided by financial institutions in Malaysia <sup>1</sup>

## WHAT CAN ISLAMIC FINANCIAL INSTITUTIONS OFFER?

Traditionally, banks and other financial institutions were considered as a mere intermediary between the lender and the borrower. Social considerations were barely present in the business portfolios of financial institutions until the introduction of 'Corporate Social Responsibility' (CSR), Environmental Social Governance (ESG), Socially Responsible Investment (SRI) and Impactful Investment (II). Like many other financial institutions, Islamic Financial Institutions or IFIs have become a major player in the financial markets of many countries. In Malaysia, IFIs have already provided similar incentives/ relaxations that conventional financial institutions provided for the public. But what additional value or incentives can IFIs exclusively offer during this trying period?

This answer becomes more relevant for nations where Islamic finance is endemic, like Malaysia where the size of the Islamic finance industry exceeds 30% of total finance assets.

IFIs in Malaysia have realized that their role in the economy may extend beyond the conventional financial intermediation in order to hold the mantle of value-based intermediaries (VBI). Islamic banks in Malaysia began the VBI journey in 2018. Value-based intermediation (VBI) aims to deliver the intended outcomes of Shariah (Islamic law) through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders' sustainable returns and long-term interests. It seems that the pandemic has presented an opportune moment for IFIs to exhibit their unique socio-economic principles and perform their value-based responsibilities. What then can IFIs do to fulfil this role?

<sup>1</sup> Source: Bank Negara Malaysia, Life Insurance Association of Malaysia, Malaysian Takaful Association Illustration: Research Management Centre, INCEIF



Figure 2: Underpinning thrusts of VBI in the context of COVID-19 <sup>2</sup>

As shown in the figure 2, one of the important thrusts of VBI is solving common issues faced by communities. As COVID-19 has adversely impacted communities in several ways, IFIs could empower communities through provision of financial solutions that create positive impact. In the context of social obligation, those who are capable have the responsibility to assist those who are not, via effective distribution of wealth. IFIs could play a significant role in creating socio-economic impact for the communities by being a responsible intermediary.

Balanced consideration between commercial and social aspects should provide a central lynchpin for IFIs in navigating its strategic decisions, thus encouraging the practice of giving back to society, beyond corporate social responsibility activities.

Integration of peculiar features of Islamic social finance, such as Zakat, Waqf and Sadaqah could also be executed effectively during this period. The unique feature of these funds is unilateral payment, and it reduces the financial difficulties of beneficiaries as they are not required to pay back for the monetary benefit received during the period.

<sup>2</sup> Source: Bank Negara Malaysia, Illustration: Research Management Centre, INCEIF

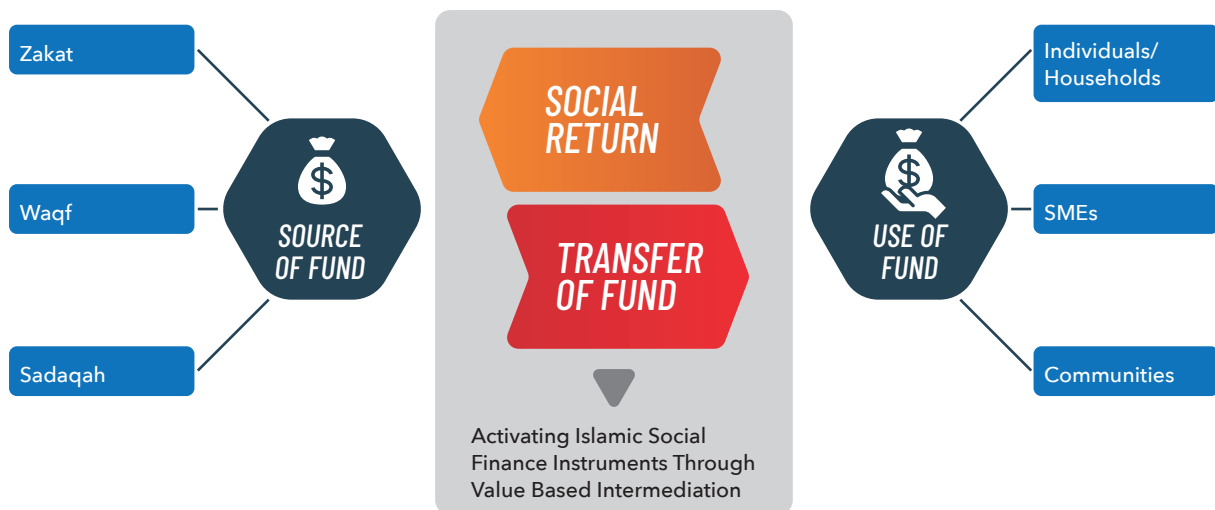


Figure 3: Illustration of Value Based Intermediation with Islamic Social Finance instruments<sup>3</sup>

What follows are some suggestions that may be adopted by IFIs in the spirit of the *Maqasid* (objectives of Islamic law) and the premise of VBI. These suggestions, if adopted, may support society during financial distress through IFIs applying Sadaqah, Waqf and Zakat as well:

## ROUNDING UP OF PAYMENTS PROGRAM

This proposal refers to the process of raising money for a specific purpose by using retail transactions at either a retail store's point of sale (POS) terminal or via an online website through rounding to the nearest unit. Whenever individuals make a transaction using an online platform, the transaction amount is rounded up to the next desired unit. The fund provider has the option for choosing the nature of fund (Zakat/Sadaqah/Waqf) and the program (e.g. COVID-19) in which the fund could be channeled to.

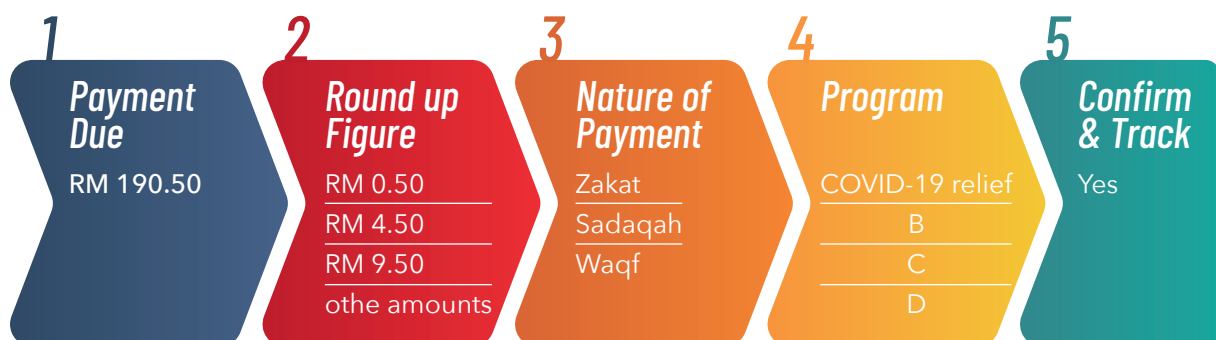


Figure 4: Illustration of Rounding up Program<sup>4</sup>

3 Illustration: Research Management Centre, INCEIF

4 Illustration: Research Management Centre, INCEIF

## LOYALTY POINTS CONVERSION PROGRAM

The Loyalty Points Conversion Program consists of converting accumulated loyalty points into monetary value before disbursing it in the form of Zakat/Sadaqah/Waqf instead of using these points for personal consumption. The fund provider has the option for choosing the nature of fund (Zakat/ Sadaqah/ Waqf) and the program ((e.g. COVID-19) in which the fund could be transferred to.



Photo: U.S. Army National Guard/Sgt. Amouris Coss

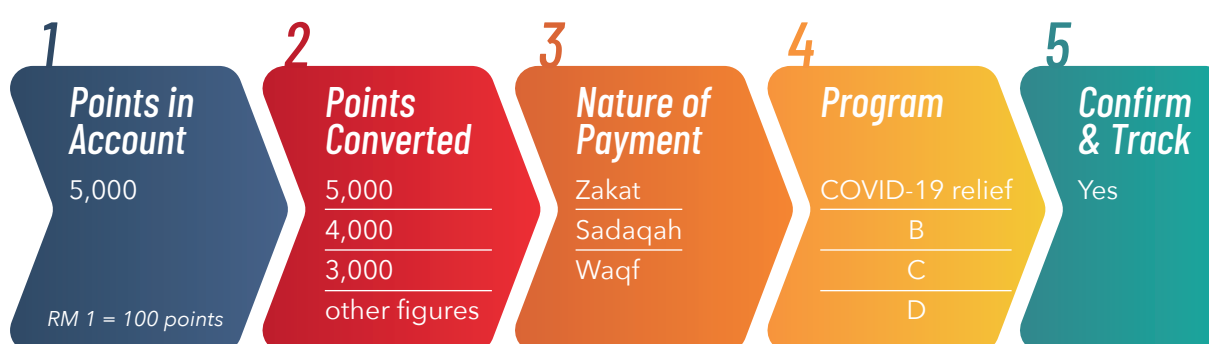


Figure 5: Illustration of Loyalty Points Conversion Program<sup>5</sup>

Daily lives and business activities have come to a virtual halt amidst COVID-19. The impact is felt globally by many with a shortage of medical supplies, daily essentials, source of income and shelter. The term 'new normal' is widely used as the way forward due to the mid and long-term effects of COVID-19. During this difficult period where unprecedented shocks are still unfolding, IFIs can collaborate to play a more significant role in bolstering support for their customers and society.

Islamic finance advocates empathy and compassion as part of the fundamental Islamic principles.

As an expression of this, IFIs can collaborate on a crowdfunding platform to create a special fund with zero profit for a predetermined short term, to cushion the impact of their customers, particularly, the micro and SME sectors.

IFIs can also crowdfund to assist in creating an emergency food bank, protective medical supplies, delivering essentials to the affected people and to provide information and resources on COVID-19. The sector can be a role model by contributing to the positive sentiment of their employees that are forced to work from home without proper support in childcare, IT equipment and internet connectivity, house and family responsibilities and financial challenges by rolling out systematic and clear remote work plans.

<sup>5</sup> Illustration: Research Management Centre, INCEIF



Photo: Universiti Malaysia Sarawak

This mutually beneficial arrangement will restore employee productivity and boost morale.

In Malaysia, the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM) stated that the outlook does not look good for IFIs. Therefore, even with adequate loss absorption buffers and stable credit profiles, the prolonging of MCO coupled with the unprecedented impact of the pandemic will dampen the financial growth of the IFI and deteriorate its asset quality. Despite having stable and diverse asset quality, the impact of the pandemic

does not discriminate and is impacting all nations and businesses everywhere. The shocks are still unfolding, and the worst is yet to be seen. However, amidst all these adversities, it remains a unique opportunity for IFIs to turn it into advantage. It is now more than ever, that IFIs can exhibit their unique social characteristics, providing forms of financial support for those in distress. It is time for IFIs to hold the banner of responsible financiers high. The returns over the long-term will surely be worth it. It's time for IFIs to *walk the talk* and show that they are indeed Value Based Intermediaries.